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The Palestinian economy

and

international trade

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Contents

An earlier draft of this paper was presented at a symposium at the University of Nijmegen on the Economic Aspects of a Political Settlement in the Middle East, the Netherlands, April 1990. Some of the ideas were further developed for the First European International Studies Conference held at the University of Heidelberg in September 1992, where the figures shown in the appendix were discussed. Further substantial modifications and additions have been made since the mutual recognition of Israel and the PLO in September 1993.

The Palestinian economy and international trade

Is there any economic sovereignty?

The economic accord agreed between the Palestine Liberation Organisation (PLO) and Israel in August 1994 represented a major compromise for the Palestinian side. It was certainly not the sort of agreement envisaged by Palestinian economists at the time of the mutual recognition between the PLO and Israel in September 1993, nor the type of outcome contemplated much earlier when Palestinian economists first considered the development possibilities for a mini state in the 1970s. Autonomy in practice seems to be much more limited and in the economic sphere the Israelis will continue to exercise control of the external economic affairs of the Palestinians.

Compromise may be politically painful, but the price may be worth paying if there are substantial economic gains. It is the contention in this paper that the accords on economic issues agreed so far not only represent a major climbdown for the Palestinian negotiators and Yasser Arafat himself, but are also unlikely to provide a satisfactory basis for a sustained economic development in the territories under some measure of local autonomy. Given the depressed state of the occupied territories following the *intifada*, the position is even more difficult. Indeed, providing a suitable framework and institutional support for development may be a daunting task. What has actually been provided so far, however, makes self-sustaining economic growth unlikely, and development virtually impossible.

The economic discussions since the mutual recognition of Israel and the PLO have proved much easier than those on political and security matters, largely because Arafat has been willing to compromise over control of Palestinian economic affairs. The most heated debate since the White House meeting between Arafat and Rabin has been over the control of the frontiers between Gaza and Egypt and Jericho and Jordan, especially in view of Israeli fears over security. These frontiers are also likely to be significant for the economy of the new Palestinian entity, as they are important crossing points for the movement of traded goods, people, and even money. These are the issues that this paper addresses. Ultimately the external commerce across the frontiers may be crucial for the stability and prosperity of the new Palestinian entity, and hence for the long-term security of Israel. Arguably this deserves at least as much attention as the immediate security issues.

The nature and orientation of the external economic relations of the new Palestinian entity are still far from clear in spite of the many years of preparation of Palestinian economists in exile, and the advanced plans for a new state which the Economics Office of the

PLO drew up. Given the substantial difference between the compromises reached and what was envisaged on the Palestinian side, these plans have been undermined. There is much confusion and disagreement over what the economic prospects actually are.

To some extent the mutual recognition came as much of a surprise to the Palestinian economists as to everyone else, as it is one matter planning in the abstract, but quite another dealing with economic realities. Even with only very partial independence, or even political control, over the entire West Bank, the economic decision making process is being changed. For the first time in their history, the Palestinians have the opportunity to have a limited say over their own material affairs. Economic sovereignty may be more restricted than for many other peoples, but some new choices have been opened up. What these choices are, and how they should be exercised, are the subject of this paper.

Worldwide linkages

Of particular importance to the Palestinians is the question of their trading and other economic linkages with their Middle Eastern neighbours and the world beyond, where the majority of those of Palestinian descent will continue to live. In order to put the choices in international economic relations into context, it is necessary to examine the current state of the West Bank and Gaza economies, and to define the type of entity they constitute and their basis for trade.

Impact of the lack of identity

The pure theory of international trade assumes a world comprised of sovereign nation states, with factors of production immobile across international frontiers, but free movement of traded goods.

Viewed from this perspective the Palestinian economy is a highly imperfect entity, at the opposite end of the trading spectrum. Firstly Palestine is not yet a state; it has little sovereignty in trading matters, and even the frontiers across which traded goods pass have yet to be fully defined. Secondly there is considerable mobility of both labour and capital, which makes it difficult to assess or delineate the factor endowment, which is usually considered as a prime determinant of the pattern of specialisation and trade.

At trade policy level there has also been a vacuum, since there has been no government or institution to represent the interests of the Palestinian people, however the population is defined. Of course organisations such as the PLO may claim to represent ultimate political aspirations, but in the past they have lacked both the mechanisms and real power to take effective action over day-to-day economic issues affecting their own people.

At the same time Israel was perceived by most Palestinians as an occupying power, more likely to act against, rather than in support of, legitimate Palestinian trading interests. Palestinians were therefore effectively unrepresented in major trade forums, including GATT, and could not carry out effective trade negotiations with bodies such as the European Union (EU) despite the significance of the latter for their own economic interests.

There was a considerable amount of literature during the 1970s on the issue of the economic viability of a Palestinian state, the territorial basis of which was assumed to be the West Bank and Gaza, usually including East Jerusalem. The best known independent works were those by Brian van Arkadie,[1] Vivian Bull,[2] and Elias Tuma and Haim Darin-Drabkin.[3] These studies were primarily concerned with the structure and development of the Palestinian economy internally, with little discussion of external economic relations. The West Bank and Gaza were examined in isolation, the question being whether self-sustaining economic development was possible, with much stress on the objective of a degree of self-reliance for industry and the promotion of self-sufficiency in agriculture.

Not surprisingly Israeli studies have been more concerned with the trade and external economic relations of the West Bank and Gaza, especially the close links with the Israeli economy that have developed since the 1967 occupation. Such issues have always been prominent in the successive Bank of Israel Research Department Surveys .[4] Israeli academics have also focused on trade and payments issues.[5] The integration of the territories into the larger Israeli economy is seen as being economically beneficial, offering positive mutual gains, but with most emphasis on the benefits to the Arab side.

Dependence on neighbours

Of course any territorial entity with a population of less than 1.6 million, as is the case with the West Bank and Gaza, must inevitably be dependent on its neighbours which in this instance are Israel and Jordan. The dependency not only involves direct imports, but also markets for exports, and financial inflows in the form of investment and remittances. For visible trade both Israel and Jordan in most instances act as conduits, rather than ultimate sources of, or destinations for, goods. For invisibles, their direct importance is greater, especially in Israel's case.

For the West Bank and Gaza the gains from trade are not those associated with specialisation and increasing returns in production. Rather the gain is sheer economic survival, as without open borders and goods from

[1] Brian van Arkadie *Benefits and Burdens: A Report on the West Bank and Gaza Economies Since 1967*, Carnegie Endowment for International Peace, New York, 1977.

[2] Vivian Bull *The West Bank - Is It Viable?* D.C. Heath, Lexington, Massachusetts, 1975.

[3] Elias Tuma and Haim Darin-Drabkin *The Economic Case for Palestine*, Croom Helm, London, 1978.

[4] See for example: Dan Zakai *Economic Development in Judea-Samaria and the Gaza District 1985-86*, Bank of Israel Research Department, Jerusalem, 1988.

[5] Ron Baums and Yoel Raban *The Economy of Judea and Samaria: 1968-1986*, The Armand Hammer Fund for Economic Cooperation in the Middle East, Tel Aviv University, 1989.

outside, life could hardly be supported, even at a dangerously low level. There is no choice but to import as the local agricultural economy cannot sustain the population with basic subsistence provision. The ending of the occupation in Gaza and Jericho has brought the promise of external financial inflows which may help development, but the basic resource endowment remains the major constraint on agriculture. In the absence of a developed manufacturing sector, most household goods also have to be imported, together with all capital and intermediate goods. The external dependence is virtually total and all embracing. The only issue is how to pay for the goods imported, given that export production is extremely restricted. The question is not so much one of exchange, as one of actual payment.

Agricultural resources

The West Bank and Gaza are both basically agricultural economies with little industrial activity historically, apart from that related to agriculture. The cultivated area of the territories is extremely limited, reflecting their small size, low rainfall and, in the case of the West Bank, the upland nature of the terrain. The total area under cultivation in the West Bank remains less than 2,000 sq km, while that of the Gaza strip is only 210 sq km. The Palestinian Arab economy of both territories has been squeezed by the newly established Israeli settlements, which occupy over one-tenth of the land area, and use a substantial proportion of the territories' water resources. Only 5 per cent of the West Bank is irrigated in any case, though in Gaza the proportion exceeds 45 per cent.[1]

The main output in Gaza is citrus production, with grapefruit, oranges and lemons the predominant crops. Banana production increased considerably in the 1970s, and watermelons are also an important crop for the local market. Other fruit produced includes peaches, plums, apricots and a small quantity of apples for domestic consumption. Vegetable output includes potatoes, sweet potatoes, tomatoes, cucumber, garlic, carrots, courgettes, aubergines, peppers, radishes and onions. This output ensures local self-sufficiency of fresh fruit and vegetables, but apart from some citrus, there is little surplus for export. The grading and packing of citrus produce is in fact the major industry of Gaza, and the territory has the largest single packing plant in the region, bigger even than any in Israel.[2]

Agricultural production is much more variable on the West Bank than in Gaza, largely because it depends on the region's uncertain rainfall rather than on irrigation. Potatoes, tomatoes, carrots and onions are also grown, as well as small quantities of courgettes, aubergines, cabbages and cauliflower. The major items of fruit

[1] Elias Tuma and Haim Darin-Drabkin *The Economic Case for Palestine*, Croom Helm, London, 1978, pp. 60-64.

[2] Coordinator of Government Operations in Judea-Samaria and the Gaza District *Judea-Samaria and the Gaza District: A Sixteen Year Survey (1967-1983)*, State of Israel, Ministry of Defence, Jerusalem, November, 1983, pp. 40-47.

production are oranges, bananas and apples, with citrus fruit and banana production concentrated in the Jericho area of the Jordan Valley. Olive oil production is significant on the West Bank, but the industry has been stagnant at best in recent years, and the number of olive presses has declined. Output rose with the introduction of more productive presses in the 1970s, but the gains were of a once only nature. Marketing problems are a major constraint and low prices have reduced revenue, with the result that the trees are often neglected.

Animal husbandry has also stagnated, with a decline in output of both lamb and mutton, the major livestock products. Poultry and egg production have increased with the introduction of battery units on both Palestinian Arab farms and the new Jewish settlements, though the desirability of such production from the point of view of both human health and animal welfare must be open to question. The extensive spraying of fruit crops and the substitution of fertiliser for animal manure also gives some cause for concern, but neither Israelis nor Palestinian Arabs seem much worried by these environmental issues, being perhaps, not unnaturally, more preoccupied with their own problems than with wider global questions.

The rise in crop production in the 1970s in both the West Bank and Gaza was not sustained in the 1980s in any case, and agricultural output is virtually stagnant. Given the limited land area, qualitative rather than quantitative improvements are most needed to raise the value of marketed output and farm income. However, conservative tastes, falling purchasing power since the *intifada* (uprising) and the lack of foreign marketing opportunities have discouraged any innovation in this regard. The Israeli extension effort in the early 1970s, though limited, had a marked impact on yields through the advice on fertiliser application. The production rise did not continue, however, and has not been followed through by other innovations. Contacts between the Israeli Ministry of Agriculture and Palestinian farmers in the occupied territories are now much reduced. In any case it is far from certain that advice from this source can be of much further assistance, even if relations improve.

The mutual recognition of Israel and the PLO has created more favourable conditions for agriculture, and the resultant international assistance will help. The human dimension is, however, only one constraint on agriculture. Physical factors, not least the poor condition of the land itself, will continue to impede production. Marketing problems will also remain, though some attempt is being made to tackle these through the Cooperative Development Project in Gaza funded by the US Agency for International Development (USAID). This has organised the marketing of eggplants, strawberries and tomatoes in the European Union.[1]

Industrial potential

The West Bank and Gaza have little industry, most traditional

[1] Information from Aown Shawa, marketing consultant for the project.

manufacturing being closely related to agriculture. Fruit packing, for example, is considered to be an industry in the territories, though it can hardly be considered as a type of manufacturing activity. The pressing of olives to produce olive oil could be more properly described as manufacturing, but this is far from being a major activity. Other traditional activity included the curing of sheepskin for the leather industry, most of the skin being manufactured into bags and coats in the *souks* of the old city in Jerusalem. This industry continues, being geared largely to the tourist market, but it is more a handicraft production than a major source of employment.

Industrial development was minimal during the period up to 1967 when the West Bank was part of Jordan, most new ventures being located on the East Bank.[1] Amman developed significantly as a manufacturing centre, while East Jerusalem and West Bank towns from Hebron to Nablus stagnated. The soap industry was one of the few non-agricultural related activities, but it employed less than 50 people. Construction, including quarrying and building supplies, was more significant, but this really took off only in the 1970s with the rise in remittances from the Gulf and the earnings inflow from Palestinians working in Israel. Outside the construction sector the main impact of the Israeli economy was through some sub-contracting of textile and clothing work; but the importance of this should not be exaggerated as fewer than 4,500 workers were involved, and the remuneration was extremely poor, even by textile industry standards.[2]

The limited extent of industrialisation can be seen from the employment statistics: only 10,750 people are classified as working in industry on the West Bank and a mere 6,769 in Gaza.[3] Many more workers from the occupied territories are, of course, employed in Israeli industry. In one sense, therefore, the figures on local industrial employment understate the impact of industrialisation. A major question in the economic talks between the PLO and the Israelis is whether such labour migration will be allowed to continue. There are many in Israel who would like to see Gaza sealed off and the movement of people halted for security reasons. On the other hand closure at the border results in loss of income for Gaza, real economic hardship and arguably increased support for *Hamas*. Movement of goods can, of course, be a substitute for the movement of workers. If the migration is halted, then the need for industrialisation will be considerably greater because of the need to create jobs. With a limited market within the West Bank and Gaza, industrial prospects will clearly depend on development of trade, a topic which must now be considered.

[1] Richard Ward 'The Economics of a Palestinian Entity', in Don Peretz, Evan Wilson and Richard Ward (eds.) *A Palestinian Entity*, The Middle East Institute, Washington, 1970, pp. 106-114.

[2] Fawzi Gharaibeh *The Economics of the West Bank and Gaza*, Westview Special Studies on the Middle East, Boulder, Colorado, 1985, pp. 83-94.

[3] Israel Central Bureau of Statistics *Judea, Samaria and Gaza Area Statistics*, Volume XX, 1991, p. 23 and p. 33.

Trade prospects for the Palestinian Autonomy

Any Palestinian entity based even on the whole of the West Bank and Gaza will, because of its restricted territorial size and relatively small population, inevitably depend on trade if a reasonable standard of living is to be achieved for all its citizens. It would be pointless for the new state to attempt to cut itself off from the outside world economically, or even to try to achieve self-sufficiency behind quota or tariff barriers. The limited domestic resources of the West Bank and Gaza mean that the territories, by themselves, would be unable to feed their present populations, let alone provide subsistence for those returning from adjacent Arab countries. It is only through internal specialisation and external exchange with neighbouring states that a new Palestine will be able to afford to pay for its food requirements and purchase the machinery and capital equipment needed for industrialisation.[1]

It is incorrect, however, to believe, as many do in the developing world, that frontiers open to trade imply vulnerability. Countries that depend on the export of one or two primary commodities whose prices are unstable in world markets are of course vulnerable, as is Jordan in the case of phosphate exports. Clearly the West Bank and Gaza will want to avoid such dependence, which necessitates a programme aimed from the start at export diversification. The territories are unfortunate in not being endowed with rich mineral and oil resources like other parts of the Middle East, but the advantage is that at least they will not be tempted into an easy dependence. Palestine's main resources are human rather than physical, and here it can be noted that countries whose main strength was the skills of their citizens have historically found it easier to adapt to economic change and trade upsets than those which relied on the export of raw materials.

Dependence on a single market, or on one or two markets, also makes countries vulnerable, as there is little they can do if their customers impose trade restrictions or take other measures to curtail domestic demand. Only if the foreign market which a country supplies is also a major supplier of its imports can successful retaliatory action be contemplated. Inevitably a Palestinian economy, because of its limited significance as an import market, is unlikely to be in a strong position to take such countervailing measures should its main customers impose restrictions on its imports. In any case the new state will probably not conduct trade on such a bilateral basis, as its main export customers will certainly be within the Middle East, whereas its major sources for industrial imports seem likely to be outside the region completely. Such a trading pattern means that Palestine must attempt to diversify its export markets as much as possible to avoid

[1] A point insufficiently emphasised by many observers, even with respect to a greater Palestine. See Fouzi el-Asmar, Uri Davis and Naim Khadr *Towards a Socialist Republic of Palestine*, Ithaca Press, London, 1978, pp. 84-89.

excessive dependence on a single country whose trading policy it could, at best, influence only marginally. To put itself in the position of a competitive supplier confronted with a monopoly buyer could, in the long run, be economically catastrophic.

Existing trade patterns

Historically the West Bank and Gaza traded little with the outside world, and during the period of the British mandate from the end of World War I until 1948 their main trade was with the rest of Palestine. Some olives were exported from the West Bank beyond Palestine, and a small amount of citrus produce from Gaza found its way onto European markets, but the volume of trade was extremely low, although Gaza assumed a limited significance during World War II when the agricultural resources of the whole of Palestine were harnessed to supply the allied forces in North Africa through the Middle East Supply Centre.[1] This burst of activity was short-lived, however, and after 1945 Gaza reverted to its semi-subsistence state.

Between 1948 and 1967 the West Bank and Gaza were completely cut off from the new state of Israel, and the trade of both territories reflected their changed political alignments, the West Bank being integrated with the East Bank of Jordan, while Gaza's trade was oriented towards Egypt. Neither of the territories' economies fared well under these arrangements, as they were at the periphery of both states, and were to some extent marginalised. Gaza's citrus production, for example, was unwanted by Egypt which was unable to market successfully its own production from the Nile Valley, let alone cater for sales from the Palestinian residents of Gaza. Similarly in Jordan, while industry and trade developed on the East Bank, the West Bank was neglected; and the East Bank itself provided only a small market for West Bank agricultural exports. There was some growth in trade between Jordan and the Gulf states and Saudi Arabia, and agricultural producers on both sides of the Jordan Valley benefited from this; but the domestic markets of the oil exporting states were very limited in the early 1960s compared with what they became in the 1970s following the oil price increases and their economic expansion.

Rail and road links with Suez

From a communications standpoint nevertheless Gaza was much better placed than the West Bank during the 1947-67 period, as it had direct rail and road connections with the port of Suez and the Nile Valley. Transport of goods therefore presented little problem. The main constraints on its trade were paper ones - bureaucratic and cumbersome marketing procedures - rather than the physical constraints of transportation.

The West Bank was not as fortunate, however, as its trading links westward were cut, and it was isolated from its customary trading ports of Haifa and Jaffa on the Palestine coast. Instead, any produce dispatched

[1] M.W. Wilmingham *The Middle East Supply Centre*, State University of New York Press, 1972.

from East Jerusalem, or provincial West Bank towns, for external markets, had to be sent across the Jordan River to Amman, and then round via Damascus to the port of Beirut, a journey involving two additional countries, both of which had lengthy customs procedures at their land frontiers.

When the port of Aqaba was developed, direct trading to the east and south was facilitated, but goods destined for, or coming from, Europe had to go through the Suez Canal and bear high freight charges compared with the cost of direct shipment through eastern Mediterranean ports. A further problem in the early 1960s was the absence of surfaced overland routes from Jordan to Saudi Arabia and the Gulf. By the time these were opened, the West Bank had come under Israeli control and did not benefit as much as it might have done despite the open bridges policy, which will be discussed in more detail later.

After 1967, following the Israeli occupation, there was a drastic change in trade patterns for both the West Bank and Gaza as economic links with the rest of Palestine were restored for both territories, although the economy of the area had been transformed from 1947 as the state of Israel developed. Gaza was completely cut off from Egypt, but after a period of suspension in 1967, the Jordan bridges were reopened again after discussions between the Israelis and the Jordanian authorities. West Bank trade with the East Bank and other Arab states to the east and south was, therefore, allowed to resume.

Despite the resumption of trade with the East Bank, the links with the Israeli economy for both the occupied territories grew progressively stronger, and by 1971 Israel accounted for almost 80 per cent of West Bank imports, and almost 85 per cent of Gaza's, while the West Bank's imports from Jordan amounted to less than 5 per cent of the total. Since then the dependence has increased further for both territories, which now purchase 90 per cent of their imports from Israel. Such trade is clearly to Israel's advantage, as it provides a convenient and useful outlet for a wide range of industrial goods produced by the country's import substitution industries. Although the per capita income level is low in the occupied territories in comparison with Israel, there is still a substantial demand, from their 1.6 million Arab consumers, for the basic household goods which Israel's infant industries provide. Indeed, as Israeli industry can meet most of the requirements of low-income earners, but not the luxury goods which higher-income earners demand, the propensity to import from the outside world is actually higher for Israel itself than it is for the occupied territories because of the differential in their income levels.[1]

The market integration of the occupied territories into the Israeli economy reflects to a large extent trade restrictions imposed by the Israeli government. For foreign trade purposes the occupied territories are treated in the same way as the rest of Israel, and are subject to the same import controls and currency regulations, which means in practice that they

1 Yusif Sayigh 'Dispossession and Pauperisation: The Palestinian Economy Under Occupation', in George Abed (ed.) *The Palestinian Economy*, Routledge, London, 1988, pp. 259-261.

often have little choice but to purchase Israeli-produced goods. After the 1973 war, for example, Israel had a severe shortage of foreign exchange because of its desire to purchase more armaments: in consequence import surcharges were imposed. In addition the Israeli government ordered all importers to make special deposits at the Treasury equivalent to 20 per cent of the value of any goods imported. These deposits were held for one year before being refunded, and no interest was payable.[1]

A further factor which makes it more difficult for those in the occupied territories to import goods from outside Israel is the widespread use of the Israeli shekel. There are no foreign exchange conversion costs when Israeli goods are purchased, but there are when goods are purchased from other sources. Remittances to the occupied territories from Arab countries were usually denominated in Jordanian dinars and US dollars, but these have fallen. Although the Jordanian dinar is to be the official currency in Jericho and Gaza, it remains to be seen how widely it is used. Palestinian workers in Israel will continue to be paid in shekels, so the continuing circulation of Israeli currency in the territories looks inevitable.

Trade growth

Given the obstacles which prevented the growth of trade in the West Bank and Gaza prior to 1967, it is not surprising that the initial experience of the post-occupation period compared favourably, despite the new constraints which the Israeli administration brought. At first sight the increase in the value of exports and imports over the 1971-77 period for the occupied territories looks spectacular with trade increasing eightfold for the West Bank, and thirteenfold for Gaza. However, the Israeli figures use current prices, and when account is taken of the extremely high rate of inflation experienced in both territories as well as in Israel itself, the increase is much more modest. As far as internationally traded goods are concerned, the changing exchange rate for the Israeli currency is probably a better indicator of this inflation than the Israeli-compiled retail or wholesale price indexes. These are a poor indicator of inflation in the occupied territories in any case because of the weighting employed. Using the exchange rate as an admittedly rough and ready deflator, the trade of the West Bank would appear to have increased around twofold over the 1971-77 period, while for Gaza the increase was nearer threefold.

Impact of freedom from Israeli constraints

Given that trade has increased despite the constraints imposed by the occupation, there can be little doubt that much more activity would be generated if the West Bank and Gaza were freed from existing binds. The customs accords between Israel and the PLO on 14 August 1994 did not bring any change in the existing trade regime for the West Bank and Gaza. Imports there will continue to be subject to the same duties as

[1] Rodney Wilson *Trade and Investment in the Middle East*. Macmillan, London, 1977.

those entering Israel. The only change is that the revenue collected by Israeli officials for goods destined for Gaza and the West Bank will be handed over to the PLO.[1] Israel's policies are naturally designed for its own needs, with certain tariffs designed, for example, to give infant industry protection. As the West Bank and Gaza have little industry to protect, such tariffs would be unnecessary if the territories were economically independent, although some tariffs may be needed to assist the balance of payments on a temporary basis, or to raise revenue for government expenditure initially once a new state was established.

The same considerations apply to exchange rate policy. Israel's many past devaluations helped to stimulate demand for its own exports, especially industrial exports, as demand for these is relatively price elastic in international markets. The devaluations and depreciations were of less use to exporters from the West Bank and Gaza, as demand for their agricultural exports is more price inelastic, with the lack of alternative supplies rather than price being the key factor for the customer in Saudi Arabia and the Gulf where most of the produce ends up after being transhipped through Jordan. Since 1992 the Israeli currency has stabilised, and it is the Jordanian dinar which has been subject to devaluation. By adopting the Jordanian dinar as the official currency for non-Israeli trade, the PLO may find that the previous problems continue. There is an unfortunate irony in these currency changes, yet Palestinian economists recognise that the territories are not in a position to support an independent currency at present.[2]

Despite the increase in trade in recent years in both the West Bank and Gaza, the absolute value of goods traded remains small, with the combined exports of both territories worth only $300 million in 1987, the last year for which detailed figures are available, while the value of combined imports in that year was $650 million. In relation to the export potential of both territories, the 1987 value is still low, while the import figures are distorted by the need to purchase from Israel even basic consumer goods which could be made locally if import substitution industries were established. The 1987 figures show a combined deficit of $350 million which looked at in isolation seems to be a rather unhealthy trading situation. The value of this deficit has risen steadily ever since the occupation, although the relative position of exports has improved remarkably in Gaza, especially since 1975.

Trade with the Gulf

More detailed analysis of the deficit for the occupied territories shows that most of it is in trade with Israel, whereas there was a surplus of $80 million

1 Julian Ozanne 'Israel and Palestinians settle customs accord', *Financial Times*, 15 August 1994, p. 6.

2 The absence of Palestinian financial institutions in the occupied territories raises further problems. See Lawrence Harris 'Money and Finance with Underdeveloped Banking in the Occupied Territories', in George Abed (ed.) *The Palestinian Economy*, Routledge, London, 1988, pp. 191-222. This issue has also been considered by the author. See Rodney Wilson 'The Palestinian Problem', in Peter Johnson and Barry Thomas (eds.) *Economic Perspectives on Key Issues*, Philip Allan, Oxford, 1985, pp. 24-26.

in trade with Jordan in 1987. Most of the exports recorded as being destined for Jordan are in fact transhipped in Amman and forwarded to Saudi Arabia and the Gulf as already indicated, so this surplus refers to the trade with all Arab countries and not just Jordan, which is a comparatively minor trading partner. The trade is only recorded as being with Jordan as the data is collected by the Israeli military authorities at the bridges over the River Jordan.[1]

There is also an overall deficit in the trade of the occupied territories with the outside world as recorded at Israel's ports and airports. Little of this trade has been with the Arab countries because of the boycott of Israel and therefore of all goods shipped out of its ports directly. The biggest share of the deficit which the West Bank and Gaza recorded with the rest of the world was with Western Europe and the Far East; the share of other regions was negligible. Although small in relation to the deficit with Israel, this deficit must cause concern for the planners of the future Palestinian economy. The deficit with Europe and the Far East is likely to mount with the aid inflows to the West Bank and Gaza. Inevitably there will be a growing trade deficit as a counterbalance to any capital inflows.

Many Palestinians would prefer not to continue trading with Israel, or at least to reduce the extent of that trade. However this will not happen under what was agreed in August 1994. The PLO-Israel trade accord is far from being ideal from the Palestinian point of view, and even economic theory would suggest that it is unsatisfactory for the weaker party. The Palestinians will have little say or influence over Israeli trade policy, yet they will continue to be subject to it. It is difficult economically to argue a case for granting trade preferences to Israeli goods against those originating elsewhere, yet this will continue to be the case. Certainly, as a result of transport costs, some Israeli goods may be cheaper than goods imported from elsewhere, and therefore it would make economic sense to buy from Israel in these circumstances. The case for a customs union between Palestine and Israel is, however, rather weak, as even the theoretical literature concludes that unions are most successful between competing economies, such as those of the European Union, rather than between developed and developing countries that complement each other.[2]

Economic relations between Palestine and Israel would operate best if they were established on a basis similar to that between any other two economically sovereign states, with existing restrictions removed on the trade of the occupied territories, and market forces left largely to determine what goods are traded. At present there is little doubt that as far as trade is concerned the occupied territories have more to offer Israel than vice versa. Although the West Bank and

[1] Israeli Central Bureau of Statistics *Quarterly Statistics on Judea, Samaria and Gaza Area*, Jerusalem.

[2] For an introduction to the literature on customs unions as applied to developing countries see the book of readings edited by Peter Robson *International Economic Integration*, Penguin Books, London, 1971, pp. 166 ff.

Gaza absorb a significant volume of Israeli manufactured goods, almost no agricultural produce grown in the occupied territories is consumed in Israel. In these circumstances the substantial deficit in trade with Israel is scarcely surprising. The agricultural produce of the occupied territories and Israel is similar, and therefore there is little scope for trade in this domain. Yet industrialisation in the occupied territories would not necessarily improve trade prospects for Palestinian goods in the Israeli market, as any infant manufacturing capacity established would have difficulty in competing with that already existing in Israel where industries are becoming more mature and beginning to realise economies of scale and managerial economies with production experience over time.

Export potential

It seems probable that the greatest export potential for the Palestinians will be with the Arab states to the east and south, especially the substantial markets of the Gulf and Saudi Arabia. As indicated earlier, there is already a substantial volume of trade at present via Jordan to these markets. Although the proportion of total West Bank exports going eastwards over the Jordan bridges fell from almost 50 per cent in 1972 to below 30 per cent in 1974, it has risen again in recent years to 37 per cent, and in absolute terms is well in excess of its 1972 value. Meanwhile, the share of exports sent from Gaza over the Jordan bridges has risen spectacularly, from only 10 per cent in 1972 to almost one-third of the total by 1987. This expansion in exports from Gaza to the Arab Asian countries appears all the more remarkable when it is realised that prior to 1967 there was virtually no trade between Gaza and the eastern Arab world.

By allowing trade over the Jordan bridges, the Israeli authorities have to a considerable degree implicitly recognised that their own market and marketing outlets were inadequate for the occupied territories, and that the West Bank and Gaza really need access to a wider Arab market. This is not to deny, of course, that Israel's main motive for allowing the trade was self-interest, as the foreign exchange earnings of the occupied territories are converted into Israeli shekels. This helps their currency, as well as the Israeli economy generally, through local multiplier effects, since a considerable share of the earnings of exporters from the occupied territories is spent on Israeli manufactured goods. Although the eastern states of the Arab world and the PLO have long recognised this indirect advantage to Israel of the open bridges policy, they nevertheless sensibly realise that cutting off this trade would harm the Palestinian Arabs living in the occupied territories more than the Israelis from an economic point of view, and would only make the West Bank and Gaza more dependent than ever on Israel.

Of the main export commodities from the occupied territories crossing the Jordan bridges, agricultural exports account for three-quarters of the total which amounted to $85 million in 1987. The leading agricultural export is citrus produce, which accounts for almost half of total agricultural exports. Oranges dominate this category, with popular varieties including shamouti and late oranges, but other citrus produce, including grapefruit, lemons, clementines and mandarins, is increasing in importance. Exports of cucumbers, grapes and tomatoes are also of much greater significance than before, and tomatoes especially would appear to have a considerable potential for expansion, as many of those imported into Saudi Arabia and the Gulf are of the canned variety from Italy, whereas most consumers prefer fresh tomatoes which even with existing communications links the occupied territories can supply.

At present almost all the agricultural exports of the West Bank and Gaza are dispatched in unprocessed form, which means that the local employment creation is restricted to the farm sector, and fruit- and vegetable-packing. There are no citrus processing plants in the occupied territories, yet this would be an obvious area for industrialisation with export markets primarily in mind.[1] There are, of course, many processing plants within Israel, and the Jerusalem authorities naturally favour developing this type of industry in Israel itself rather than in Arab lands. The Palestinians, unfortunately, were unable to establish such industries under the occupation without Israeli permission. World Bank and European Union officials believe that there is some scope for processing plants, although it remains to be seen how quickly such industries get established.

Obvious food processing industries which could be established in the occupied territories include fruit-juice bottling plants, a refrigerated plant for fruit-juice concentrates, fruit canning and jam and marmalade manufacture. All these products would find a ready market in Saudi Arabia and the Gulf, not merely at the expense of existing imports, but by creating new consumer demands where none currently exist. Refrigerated fruit-juice concentrates are only produced in Israel and the United States at present, and none are purchased in Saudi Arabia or the Gulf, yet transport of this item overland from Palestine to these markets would present few problems as the value is high in relation to bulk. Similarly most of the jams and marmalades consumed in the Arabian peninsula originate in Europe, and are consumed largely by expatriates. These could be manufactured using labour-intensive processes on a cottage industry basis in Palestine where they could be made sweeter to appeal more to Arabian tastes than the European products do.

The existing range of industrial goods exported via the Jordan bridges is extremely restricted, although the overall value had increased to about $40 million by 1987. Much of this consisted of quarry stones however, which are classified as a manufactured export, but in reality represent a primary resource. Traditional export goods still dominate, including olive oil based products, *samna* from sesame, certain types of soap, cheeses from the herds of goats kept by the bedouin in the occupied territories which are renowned in many parts of the Arab world and stones from the quarries of the West Bank for use in the building industry on the nearby East Bank of Jordan. Modern industrial products

[1] Bakir Abu Kishk 'Industrial Development and Policies in the West Bank and Gaza', in George Abed (ed.) *The Palestinian Economy*, Routledge, London, 1988, pp. 181-183.

such as plastics are of limited significance, accounting for a mere one per cent of the total value of exports.

The scope for expanding exports of these traditional industrial products is extremely limited. Olive yields are, for example, subject to considerable production fluctuations as already indicated, which makes the prospects for industries relying on olive oil supplies as inputs extremely problematic. Cheese production could conceivably be reorganised on a factory basis and production increased; but the product itself would then be changed in quality, and might risk losing its consumer appeal as has happened elsewhere. Ultimately in any case the ability of the West Bank to support larger herds of goats is itself in doubt - overgrazing is already a problem. Prospects for quarrying are also unpromising, as it would be uneconomic to transport stones from the West Bank's quarries further than Jordan, and anyway there are plentiful supplies of this type of building material in the Gulf, Saudi Arabia and Iraq.

Clearly if the Palestinians wish to obtain foreign exchange earnings through exports of manufactured goods, then industries will need to be established which can fulfil this function. In most cases historically industries have been developed to cater for domestic market needs before they can be expanded to serve export markets. Manufacturing industries are usually unable to compete in export markets in their early years, and indeed often require tariff and quota protection even to compete in their home market. Only as infant industries mature can they serve more than their own home base. Therefore the issue of the development of export industries cannot be separated from the question of import substitution; rather they can be viewed as part of an ongoing process.

Before considering these complex yet important questions, it is useful to look at a regional breakdown of the origin of goods' exports from the occupied territories via Jordan. This gives some indication of what areas of the West Bank and Gaza are developing fastest from the point of view of trade, and therefore throws some light on the question of industrial location with export considerations in mind. It is apparent that the share of the West Bank in the total exports of the occupied territories via Jordan decreased as a whole over the 1970-88 period, with significant relative declines shown for Nablus, Tulkarm, Ramallah and Jericho. Nablus is a major centre for olive oil extraction, and its decline reflects the mixed fortunes of that industry, which have been discussed already. From accounting for over half of the total export receipts of the occupied territories during the 1971-72 period, its share has declined to only one quarter by 1987-88. The same factors account for the falling share of Tulkarm in total exports via Jordan. The other West Bank sub-districts, Jenin, Ramallah, Jericho, Bethlehem and Hebron, were never important from an exporting point of view, and their situation has not changed much in recent years.

Of greater interest is the relative rise in significance of Gaza whose share of total exports increased from 11.4 per cent in 1972 to almost one half in 1987, and despite some fluctuations over the period as a whole, the underlying upward trend is readily apparent. This upward trend is largely accounted for by the growing importance of citrus exports to the eastern Arab world, which Gaza is well suited to provide because of its warm and sunny coastal location, in contrast to the cooler upland areas of the West Bank.[1] It must be remembered, however, that Gaza, because of its numerous refugees, has a much larger population than any single sub-district of the West Bank, and although this increasing trade across the Jordan bridges has helped boost the per capita income of some, the level still remains well below that of the West Bank. The planners of the future Palestinian economy will have to decide whether to locate in Gaza, or to diversify export production into areas such as Hebron or Ramallah. One possible solution would be to locate industries such as citrus fruit processing at Gaza, while concentrating on the West Bank those new industries which are unrelated to agriculture.

Industry and trade

At present most industrial products which the occupied territories require are imported. In order to assess the scope for import substitution in this field it is useful to consider a breakdown of these imports. The most important industrial import category is machinery and electrical equipment, which accounted for almost 16 per cent of total imports in 1987. Most of this category consists of consumer products bought from Israel, which include televisions, radios, refrigerators and other private household goods. In the Arab world Egypt is the only country which manufactures a wide range of consumer durables, but its domestic market of 50 million consumers is many times that of Palestine. In view of the limited sales potential in the West Bank and Gaza, and the intense competition in international markets where even Egypt's industry cannot compete despite over 30 years of experience in production in some instances, the merit of investment in this type of industrial development in Palestine must appear dubious.

Economies of scale are of less significance with respect to processed foodstuffs, the second biggest category of industrial imports, but this covers a wide range of items, from frozen chickens to canned meat and vegetable products. There is some scope for a processing industry in Palestine, especially in Gaza as already mentioned, but such industries are competitive only when the food inputs can be locally supplied, and at present the occupied territories are far from self-sufficient in foodstuffs. When local olive harvests are poor, for example, olives actually have to be imported to keep the local presses operating. Any expansion of the food processing industry beyond citrus and tomato production will have to wait until domestic vegetable output is augmented through further irrigation, and meat production increased by improving the quality of local herds.

Considerations concerning scale economies in production also rule out the possibility of establishing major metal goods industries, or a vehicle assembly plant, in the occupied territories. The local market for these goods is

[1] For an Israeli account of citrus development in Gaza see Gideon Weigert 'Gaza Farmers Look Forward', *Bulletin of the Jerusalem Chamber of Commerce*, April 1977, pp. 33-36.

small in any case. Some limited metal industry expansion may be possible, as there are already several small craft workshops catering for the demand from the tourists visiting the East Jerusalem bazaars in the old city. There is also scope for expanding service and repair of motor vehicles as, before the uprising, many Israelis brought their cars to West Bank garages in Nablus and Ramallah for repairs, since labour costs were cheaper there. This business has yet to revive as, despite the accords, confidence has yet to return, and conditions remain unsettled.

Fertiliser industry

Fertilisers are of some significance as an import into the occupied territories, but prospects for local fertiliser production must also be considered doubtful despite the presence of rich phosphate deposits on the East Bank of Jordan, and exploitable potash deposits in the Dead Sea. As Jordan is making efforts to develop its fertiliser industry, it is difficult to envisage, in view of the limited domestic demand in the occupied territories, that Jordan and Palestine together could support more than one fertiliser plant. In addition, as other plants are being developed in Saudi Arabia and elsewhere, future competition in Middle Eastern markets is likely to be considerable, and price expectations can hardly justify investment in this field in the West Bank or Gaza. Fertiliser production is in any case highly capital intensive by nature and is unlikely to contribute much in terms of employment creation to the Palestinian economy.

Textiles - an obvious area for expansion

By now the reader may be wondering if there are any products the occupied territories could produce outside the food processing field. Clothing and textiles are the one obvious area for expansion, especially as spinning and weaving have long been established on the West Bank on a cottage industry basis, and there are numerous small-scale clothes' manufacturing establishments. In fact these establishments, together with the food processing plants, account for most of the employment in industry on the West Bank. At present, apart from those sold locally, most of the clothing articles made in the occupied territories are sold in the bazaars of East Jerusalem. If the tourist industry develops, sales of cotton, woollen and leather goods will undoubtedly increase in these markets. Producers in the occupied territories have been more style-conscious in recent years than others elsewhere in the Arab world, and prospects for direct export to craft shops in Europe and beyond appear promising. Competition from other Third World products in these goods will, of course, be considerable, but Palestinian craft products are extremely well designed, and high quality items could easily sell for several times the retail price levels of East Jerusalem.

The clothing and textile industry has also carried out some subcontracting work in recent years for firms in Israel, catering largely for the cheaper end of the market. These economic links through subcontracting explain the surprisingly high proportion of industrial goods in the exports of the West Bank and Gaza.[1] Almost four-fifths of the total exports of the occupied territories to Israel consisted of industrial goods in 1987, and although the proportion has fluctuated slightly from year to year, this percentage was similar to that established early in the occupation years, in 1971. To some extent this of course reflects Israel's own buoyant agricultural sector, which means that it has little need of food imports from the occupied territories. It is unusual, nevertheless, to find a developed country importing such a large proportion of manufactured and semi-manufactured goods from a developing area.

Palestinians in the future could conceivably use this subcontracting experience gained with Israeli producers to carry out similar work directly for firms in Europe. Palestinians will be able to negotiate their own terms although Israeli interference is likely if it breaches the August 1994 accords. The Israeli clothing industry already manufactures under contract for European chain stores, which supply the design and material specifications. Some of these goods are ultimately produced by Palestinians rather than Israelis. By negotiating directly, and cutting out Israeli middlemen, the small manufacturing concerns in the West Bank and Gaza might well find their profits increased.

Overall, despite some obvious opportunities for expansion, the trade prospects for the West Bank and Gaza do not appear to be very encouraging as far as exports of visible goods are concerned. The limited land resources restrict the scope for increasing agricultural exports, while industrial export potential appears to be confined to processed foodstuffs, and textiles and clothing for the most part, taking account of both demand and supply considerations. Inevitably an autonomous Palestine economy will find itself in balance of payments' difficulties with respect to visible trade, which merely underlines how unwise it would be to embark on an extensive industrialisation programme which made the import bill soar without much promise of an export pay-off.

Earnings from services

There is some scope for import substitution, but industrialisation as a whole would be preferable on a modest scale, especially given the limited size of the potential workforce. Industrialisation certainly cannot be justified on balance of payments' grounds, and most foreign exchange earnings will inevitably come, in the long run through invisible earnings from services, and in the short run through capital transfers. Given these considerations, and the reservations expressed about market prospects, Palestinian economic planners are being advised to proceed cautiously and not embark on grandiose schemes like those attempted elsewhere in the Middle East. There are advantages in being a latecomer to development, as at least Palestine can learn from the mistakes others have made with industrialisation. Planners will wish to avoid the errors made in Egypt, Syria and Iraq, and can profit from

[1] Jan Metzger, Martin Orth and Christian Sterzing *This is Our Land: The West Bank Under Israeli Occupation*, Zed Press, London, 1983, pp. 111-119.

the more favourable experiences, on the whole, of Jordan and the Arabian peninsula states.

Palestine and the European Union

The European Union (EU) is the most important extra-regional trading partner of the West Bank and Gaza, and has already given the so-called 'Palestinian issue' considerable attention on both the political and economic levels. Much of the discussion during the Euro-Arab dialogue of the 1970s concerned Palestine, and the Venice Declaration of 1980 recognised the rights of the Palestinian people to self-determination.[1] The question of Palestine has also influenced the EU's dealings with Israel, though its effect on the working of the Israel-EU 1975 free trade agreement was probably minimal.[2]

Israeli researchers themselves have been more concerned with the possible detrimental effects of EU enlargement as, before the uprising, the Palestinian issue appeared rather peripheral at the economic level, despite its political significance.[3] Arguably, in any case, it was the other Arab states which were best placed to use the agreement with Israel as a negotiating position in their own discussions on cooperation, demanding at least equal concessions in their trading agreements with the EU.[4] Once again Palestinians have suffered from their lack of sovereignty status.

One issue which has been a cause of contention in the trade relations between Israel and the EU is the question of the quota and marketing arrangements for agricultural produce from the West Bank and Gaza. Israel resisted produce from the occupied territories being included in its quota for tariff-free exports to the EU, fearing that this would be detrimental to its own farmers. When the EU then agreed that a separate arrangement should apply for imports of produce from the West Bank and Gaza, Israel then raised further objections, believing that this would amount to recognition of economic sovereignty for a separate Palestine. In particular, there was insistence that all produce from the West Bank and Gaza should be sold through Agrexco, the official Israeli marketing agency.[5] As this issue threatened to undermine three protocols to the Israeli-EC Cooperation Agreement of 1974 allowing for account to be taken of EU enlargement, the Israeli side in the end relented, rather than further delay the new accords, to the detriment of its own farmers' interests.

[1] Saleh Al-Mani and Salah Al-Shaikhly *The Euro-Arab Dialogue*, Frances Pinter, London, 1983.

[2] Richard Pomfret and Benjamin Toren *Israel and the European Common Market: An Appraisal of the 1975 Free Trade Agreement*, Kieler Studen No. 161, J.C.B. Mohr, Tubingen, 1980.

[3] Yaacov Cohen *Israel's Integration in the Economic Structure of the European Community*, Ministry of Industry, Trade and Tourism, Jerusalem, 1981.

[4] Rodney Wilson *Euro-Arab Trade: Prospects to the 1990s*, Economist Intelligence Unit, Special Report No. 1105, London, 1988.

[5] David Buchan 'Brussels set to approve EC-Israel deals', *Financial Times*, London, 4 July 1988.

There is no doubt that the EU has considerable leverage over Israel, an influence which has been increased by the demise of the Soviet Union and the disinclination of the United States to act unilaterally on Middle Eastern problems as the Gulf War demonstrated. Japanese companies are prepared to sell goods to Israel, but there has been no direct investment by any Japanese enterprise in Israel, largely because of the recognition of Japan's dependence on oil and gas from the Gulf. Israel was, for example, forced to phase out discriminatory purchase tax exemptions on their own products, the so-called *tama* tax, largely as a result of EU insistence, although United States trade negotiators also backed the European position.[1]

Israel only belatedly started to consider its trading stance when it had to deal with a single European market after 1992.[2] Exports to the EU from Israel are already worth over $3,000 million, one-third of the country's total, and imports are worth twice that amount. There are fears that the deficit could widen. Fresh negotiations could easily be linked to progress on self-determination for the Palestinians.

Partly because of concern that the issue of linkage with the Palestinian talks would be raised by the EU, Israel decided to pursue dialogue with the European Free Trade Area (EFTA) countries first. The need for this was reinforced by a desire to have access to the enlarged market of the European Economic Area (EEA), through which the EFTA countries are now linked to the EU. The Israelis have agreed to reduce tariffs over a ten-year period in exchange for market access for their own goods. These arrangements will also apply to the occupied territories as no modification was made in the August 1994 accords. With the Nordic countries likely to enter the EU in 1995, it is not clear if the arrangements made with EFTA will continue to hold. Since July 1994, Israel has been in deadlock with the EU over trade.

Economic performance and resource constraints

It is of course tempting to attribute the poor economic performance of the West Bank and Gaza to the Israeli occupation, and there can be no doubt that the political status quo is an increasing hindrance to development. In the early days of the occupation living standards admittedly rose for some as a result of migration to work in Israel, and the subsequent inflow of remittances. Agricultural improvements were brought about, and there was modest industrial advance with the growth of sub-contracting. In the 1970s it was still possible to speak of the economic gains from occupation, as many Israeli observers did, though even at that time there were many in the Palestinian Arab population who suffered economic and financial losses.

Several factors increased the economic burden of the occupation as the years moved on. Firstly, Palestinian

[1] Andrew Whitley 'Israel agrees to lift disputed trade barriers', *Financial Times*, London, 8 November 1988.

[2] Hugh Cargney 'Israel starts to consider EC links after 1992', *Financial Times*, London, 24 October 1989.

Arabs, especially those from Gaza with passport difficulties, lost out on the oil boom from the mid-1970s which helped other Arab nations significantly, notably neighbouring Jordan. Secondly, the intensification of Israeli settlement in the occupied territories was to the detriment of the Arab population in terms of economic security, especially as it entailed loss of land, and, even more crucially, actual and potential water supplies. Thirdly, the economic difficulties facing the Israeli economy spilled over into the West Bank and Gaza, especially the inflationary problems. Finally the 'uprising' itself has exacerbated both short and long-term economic difficulties.

It is of course difficult to assess the present state of the economy of the West Bank and Gaza, as the only official statistics are those produced by the Israeli authorities. Even if these are accepted as unbiased, the problem in collecting any statistics in present circumstances in the occupied territories is recognised by all parties. Agents of a perceived 'enemy' power are hardly in the best position to obtain accurate data and win the trust of those surveyed. The latest official statistics, published in 1992, relate to the period up to 1987 only with respect to the balance of payments for example.[1]

Gross capital formation appears to have been stagnant in both the West Bank and Gaza since the mid-1980s, and economic growth has consequently suffered. The effects have been worst in Gaza, but both territories have fared badly. Industrial output rose modestly before the 'uprising', but has subsequently fallen back, though there are no figures to confirm this. Agricultural production continues to decline in relation to consumption, and despite some fluctuations from year to year, the long-term trend is depressing. The West Bank is of course the larger economy of the occupied territories, but it, like Gaza, remains depressed, with both industry and services in a poor state.

The trade deficit of both territories was widening even before the 'uprising' and is now undoubtedly much worse. In the event of a comprehensive peace settlement it would probably deteriorate further, in the short term at least, as foreign loans and aid fuel imports. There would undoubtedly be rising economic expectations which could be met only with goods and services supplied from abroad. In the longer term it would be necessary to raise foreign exchange earnings' capacity to achieve any degree of economic independence. This would be a far from easy task. Aid and concessional flows can never be self-sustaining, however, and remittances always decline in the long run. There is no point in trying to escape the underlying harsh economic realities if making plans for the future.

In the long term the best hope for the occupied territories must be their people. There is much under-utilised human capital. Levels of education are high by regional standards, and technical skills have improved. The closure of educational establishments had unfortunate long-term consequences, but these should not be exaggerated. The future economic difficulties are, nevertheless,

[1] Central Bureau of Statistics, *Statistical Abstract of Israel*, Volume 43, 1992, p. 741.

considerable. Without a political settlement it seems doubtful that a start can be made, however, to meet the challenges. The economic alternatives are either stagnation and ultimate decline under occupation, or a fresh, but difficult, start down the path towards development in the event of an overall political settlement.

The economic consequences of mutual recognition

It may be premature to assess the economic impact of the famous handshake between Rabin and Arafat on 13 September 1993, especially as the negotiations on both economic and political differences between the Israelis and the PLO are continuing. Nevertheless some clues are emerging from the dialogue which indicate what the shape and orientation of the Palestinian economy might be. This has come from statements from the Palestinians themselves, as well as commitments from Western aid donors and regional parties, in particular the Jordanian and Egyptian governments.

It at first appeared that funding should not be a problem for the Palestinian economy, as EU foreign ministers pledged to provide $600 million in the form of grants and low- interest loans through the European Investment Bank.[1] The United States has sponsored an emergency fund which aims at raising $590 million, and the Saudi Arabian government was pressurised by President Clinton to contribute $200 million to this fund.[2] As the Saudi Arabian government faces a growing budget deficit caused by falling oil receipts this generosity is quite remarkable. The World Bank has also indicated its willingness to provide support for specific projects, although evaluation and appraisal will have to be undertaken first.

Both the World Bank and the EU have been concerned to ensure that there is transparency and full accountability, but it has been difficult to build institutions for this purpose. There has been a reluctance to hand over money to the Palestinian administration in Gaza and Jericho. By July 1994 they were only being allowed to draw on $13 million a month, barely enough to cover the salaries of Palestinian officials and the 9,000-strong police force.

Much of the bilateral and multilateral concessionary funding is to upgrade the run down infrastructure of the West Bank and Gaza, with priority given to road repairs and housing. In the early years of the occupation the Israelis improved the road network, especially the routes to the new Jewish settlements, but since the uprising road repairs have been difficult and there has been little new construction or widening. Although investment in roads and housing is highly desirable socially, its contribution to improving the economic base of the West Bank and Gaza is likely to be minimal. It can, of course, be argued that those in better housing work more effectively, but it would be difficult to prove

[1] *Communication from the Commission to the Council and the European Parliament on support for the peace process*, Com (93) 458, Brussels, 29 September 1993, p. 2.

[2] *Financial Times*, 10 September 1993, p. 4.

that the productivity of the Gaza workforce has suffered in the past because of this. Similarly better roads may speed up freight and passenger travel, but the gain of a few minutes or even an hour is not likely to make much economic impact, especially given the low cost of road transport in the territories in any case.

The PLO would like to see a new port at Gaza, and even a Palestinian airport somewhere in the territories. Such schemes would be very expensive, which is one reason why the PLO's estimate of its expenditure needs is $2,000 million a year over an eight-year period. In contrast, the World Bank estimates that a total of $3,600 million would suffice over the entire period.[1] The case for another port on the eastern Mediterranean coast is not strong, as there is spare capacity at Ashdod a mere 40 kilometres north of Gaza, and Jaffa and Haifa are more accessible from the West Bank. The coast off Gaza is shallow, with sand drift, so extensive dredging would be needed.

For Palestinian trade with the East, Aqaba can be used. Under the Israel-Jordan peace treaty signed on 17 October 1994, Israel will use the port of Aqaba for its eastern trade, releasing the land used by the port in Eilat for tourist development. Under this agreement, Jordan is to use Israel's ports at Haifa and Ashdod, with the Allenby bridge and a new crossing, south of the Sea of Galilee, to be used for transit.[2]

The case for a Palestinian airport is also weak given the capacity at Tel Aviv. The Israelis are unlikely to agree to the revival of Qalandia airport which served East Jerusalem prior to the 1967 occupation. It would make more commercial sense for the Palestinians to argue the case for slots at Tel Aviv and Amman for an airline of their own. The Heathrow-Tel Aviv route could be divided three ways, for example, between British Airways, El Al and a new Palestinian commercial airline. It is more important for the Palestinians to gain access to valuable flight slots abroad than to have an airport of their own from which departures would go only to less popular airports - such as Stanstead or Luton in Britain's case. A heliport in the Jericho area, offering a shuttle service to Amman, Tel Aviv and possibly Gaza, might be viable.

A tourist industry could constitute an important sector for the Palestinian economy.[3] The industry has suffered since the occupation, with Israeli agencies rather than Palestinian operators taking much of the business.[4] The uprising has resulted in few visitors venturing onto the West Bank, with even towns such as

[1] *Financial Times*, 21 September 1993, p. 5.

[2] Julian Ozanne 'Cornerstone for a new Middle East', *Financial Times*, 18 October 1994, p.5.

[3] Hisham Awartini, 'Palestinian-Israeli Economic Relations: Is Cooperation Possible?' Paper delivered at a conference at the John F. Kennedy School of Government, Harvard University, November 1991, pp. 15-17.

[4] United Nations Conference on Trade and Development, *The Tourism Sector and Related Services in the Palestinian Territory under Israeli Occupation*, Report SEU 7, Geneva, December 1991.

Bethlehem and Hebron receiving few visitors. There are no four- or five-star hotels in either Gaza or Jericho, but there should be scope for at least one on a beach location near Gaza and another near the old town of Jericho. A Palestinian airline could offer low cost stopovers, including a helicopter shuttle for passengers willing to transit through Amman or Tel Aviv on routes between the Far East and Europe.

There are some signs that financial services have revived with the momentum towards peace. Since 1967 there has been a financial vacuum in the occupied territories as the Jordanian banks were forced to close, including the Arab Bank which is widely regarded as the main Palestinian bank. Two small branches of the Cairo Amman Bank were permitted to open in the late 1980s, but since September 1993 the situation has been transformed. Eight banks operating in Jordan have plans to open branches in the territories including the British Bank of the Middle East and Grindlays. The Bank of Jordan has already acquired premises in Ramallah.[1]

A large part of the business of the commercial banks which establish branches in the West Bank and Gaza is likely to be trade finance. At present this is largely carried out through Jordan, with money-changers in Jerusalem offering courier services to the banks in Amman. Transaction costs would be reduced if documentary credits and other trade financing facilities could be offered within the Palestinian economy. The Cairo Amman Bank conducts transactions in both Jordanian dinars and Israeli shekels, and the new banks appear to be doing the same. Palestinian economists would like to see eventually a fully fledged Palestinian central bank and a separate Palestinian currency, but they have agreed that during the transition period the Jordanian dinar will be the main medium for transactions. The Central Bank of Jordan is to have monetary responsibility, and will play a supervisory role over the banks in the territories.[2] It has already had detailed technical discussions with the Central Bank of Israel over the mechanism for exchange conversions from dinars into shekels and vice versa, and there are to be officially quoted rates. At present unofficial rates vary widely, and some money-changers convert indirectly through vehicle currencies, usually the US dollar, which adds to transaction costs.

A new Palestinian Economic Council for Development and Reconstruction (PECDAR) has been established, although there remain considerable doubts over its funding.[3] The PLO would like to see this new institution handle the disbursement of EU, United States, Gulf and World Bank funding. This is unacceptable to these donor governments and agencies. There is a need for active Palestinian involvement, however, but the compromise reached so far for joint

[1] *Financial Times*, 25 November 1993, p. 5.

[2] *Financial Times*, 25 November 1993, p. 6.

[3] Julian Ozanne 'Palestinian leaders jostle to hold economic reins', *Financial Times*, 8 July 1993, p.4.

management only applies to a small portion of official financing. The latter will be primarily for infrastructure work, but this should enhance the returns on private sector productive projects that use the subsidised infrastructure.

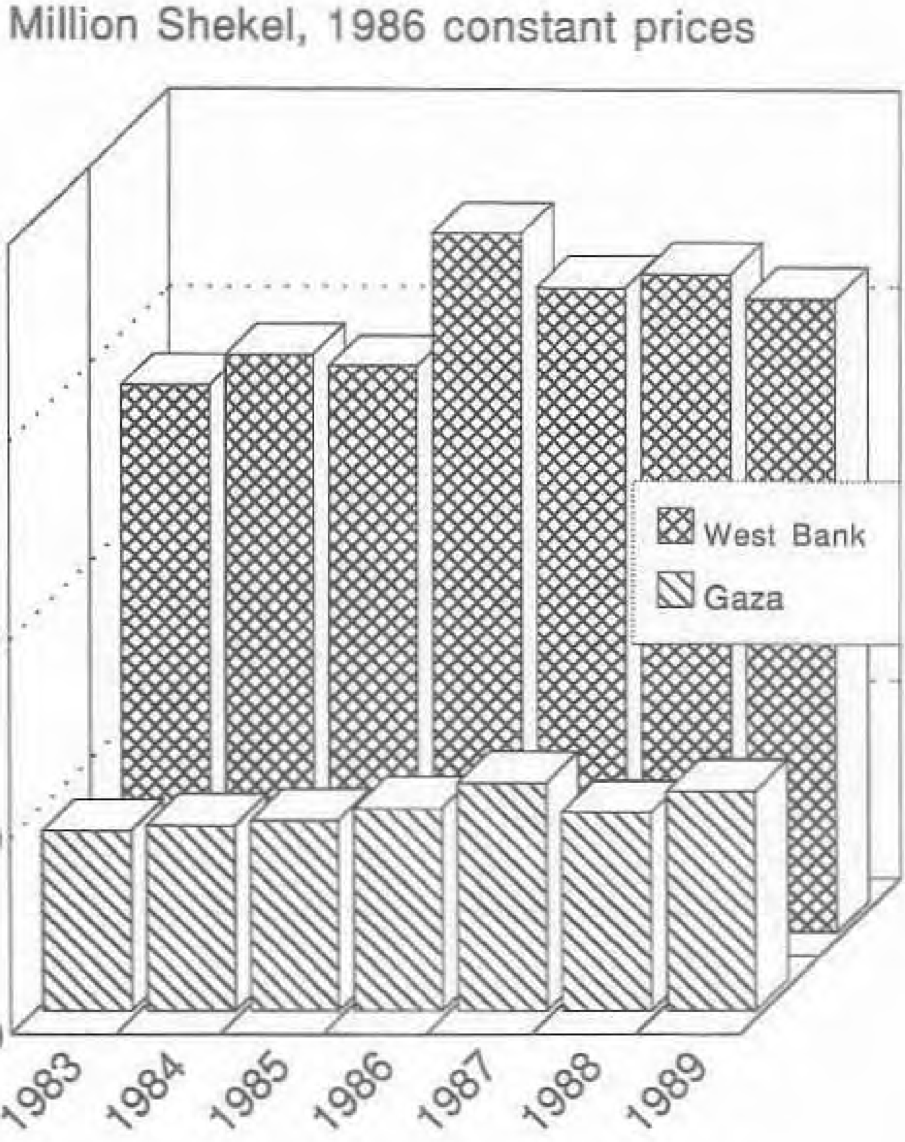
Israel insisted on its customs union with Gaza and the partially autonomous Jericho area, with the harmonisation of external customs duties and taxes.[1] Their concern is that, without this, re-exports of goods from the Far East into Israel would be possible, if there were reduced or zero tariffs at the Allenby bridge and then free entry from the Jericho enclave into Israel. Most Palestinian economists recognise the importance of maintaining free trade with Israel, but saw a customs union as limiting their freedom to pursue trade initiatives of their own.[2] Some Palestinians would like to see Gaza, especially if it had a port, and Jericho, becoming tax free zones to stimulate their commercial activity. Clearly, apart from the political differences between the two sides there are real economic differences, but under the Accord of August 1994 Israel dictated the solution.

There are daunting economic as well as political issues to resolve if the mutual recognition is to lead to a lasting peace. Expectations have been raised that material conditions will improve for the Palestinians, and unless there is an economic revival in Gaza and Jericho, the peace process will be seriously undermined. Given early aid and financing pledges, shortage of funding is not the major problem although disbursement has been slow. The challenge is to ensure that resources are deployed efficiently so that development can be self-sustaining in the long term. Short run consumption gains will not bring the economic dignity many Palestinians want, especially if Gaza and Jericho become even more dependent economies, subject to international patronage. The task is to create trading opportunities that benefit a substantial number of families through both international and intra-regional commerce that takes advantage of the education and skills which many Palestinians have to offer. What has been agreed so far between the PLO and Israel does not suggest a promising economic future. The abilities of the Palestinians in the territories are likely to continue to be wasted, with frustrations increasing as development fails to occur.

[1] *Financial Times*, 16 November 1993, p. 5.

[2] Ephrain Kleiman 'Some Basic Problems of the Economic Relationship between Israel and the West Bank and Gaza', Paper delivered to a conference at the John F. Kennedy School of Government, Harvard University, November 1991, pp. 16-23.

Figure 1
GDP of the Occupied Territories

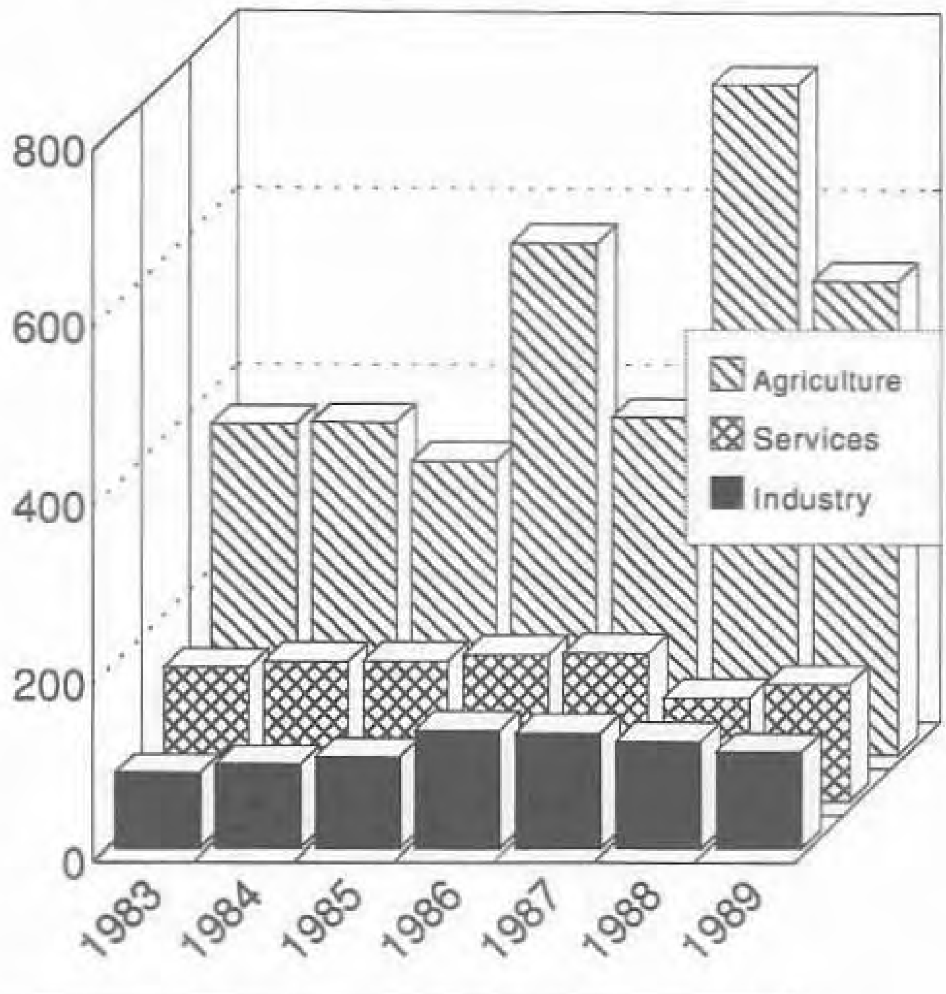


	1983	1984	1985	1986	1987	1988	1989
West Bank	1,388	1,466	1,436	1,774	1,638	1,672	1,611
Gaza	459	473	486	517	581	508	561

Source: Israel Central Bureau of Statistics, 1993

Figure 2
Composition of West Bank GDP

Million Shekel, 1986 constant prices

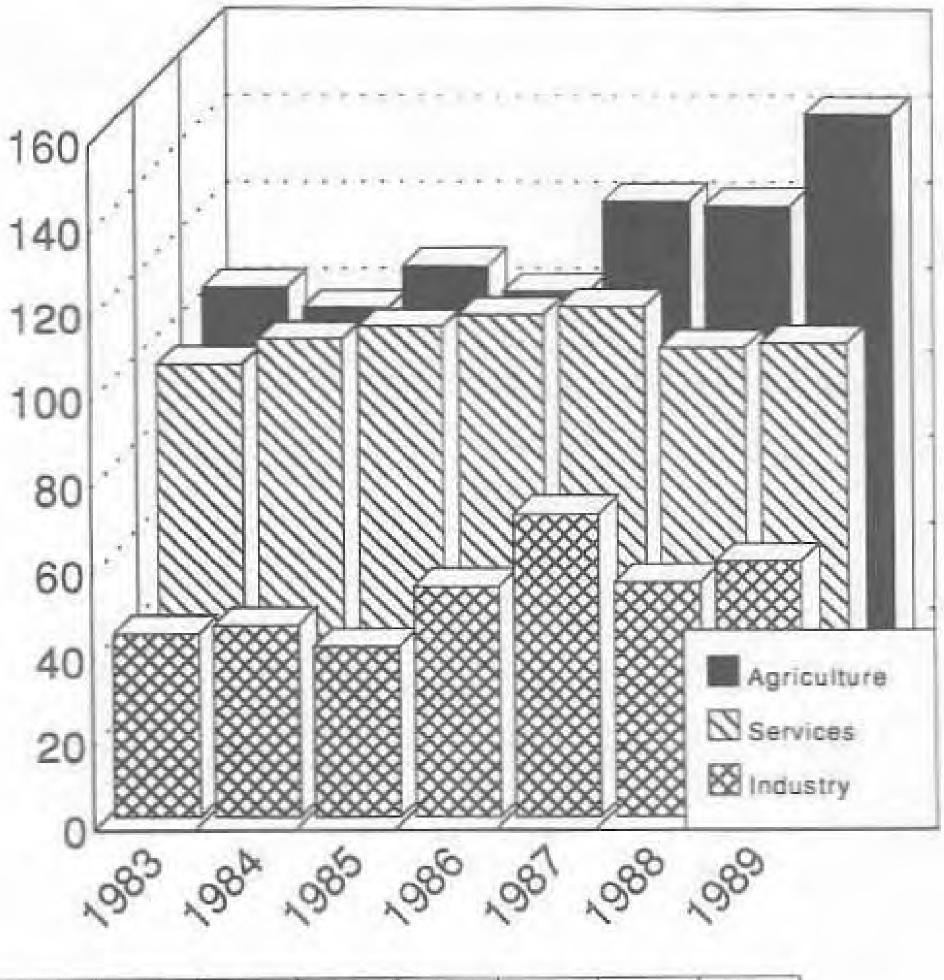


Agriculture	371	373	330	575	379	757	533
Services	150	157	158	165	167	117	132
Industry	85	95	104	134	131	122	110

Source: Israel Central Bureau of Statistics, 1993

Figure 3
Composition of Gaza GDP

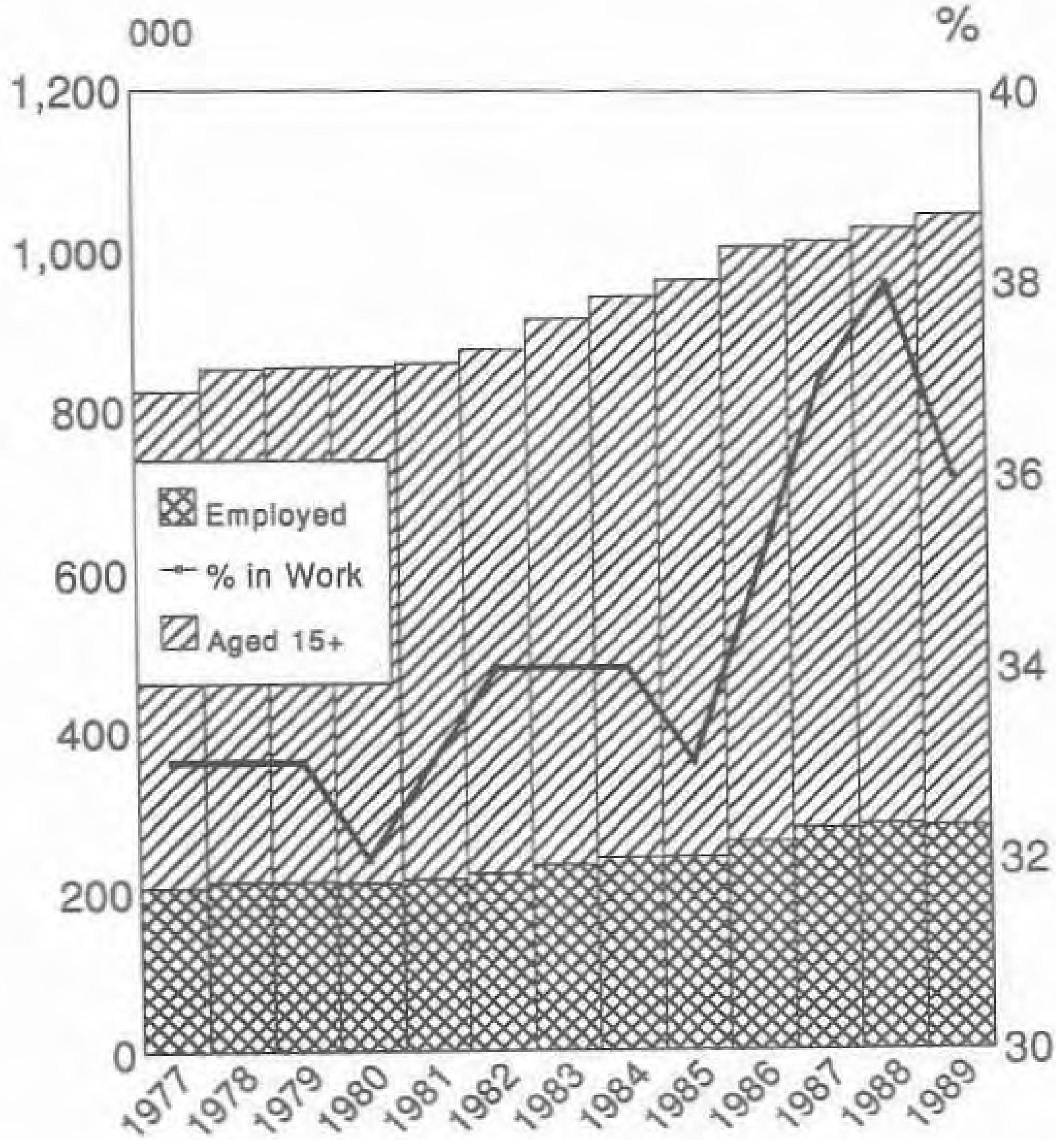
Million Shekel, 1986 constant prices



	1983	1984	1985	1986	1987	1988	1989
Agriculture	103	98	108	102	123	122	143
Services	95	101	104	107	109	99	100
Industry	43	45	40	54	71	55	60

Source: Israel Central Bureau of Statistics, 1993

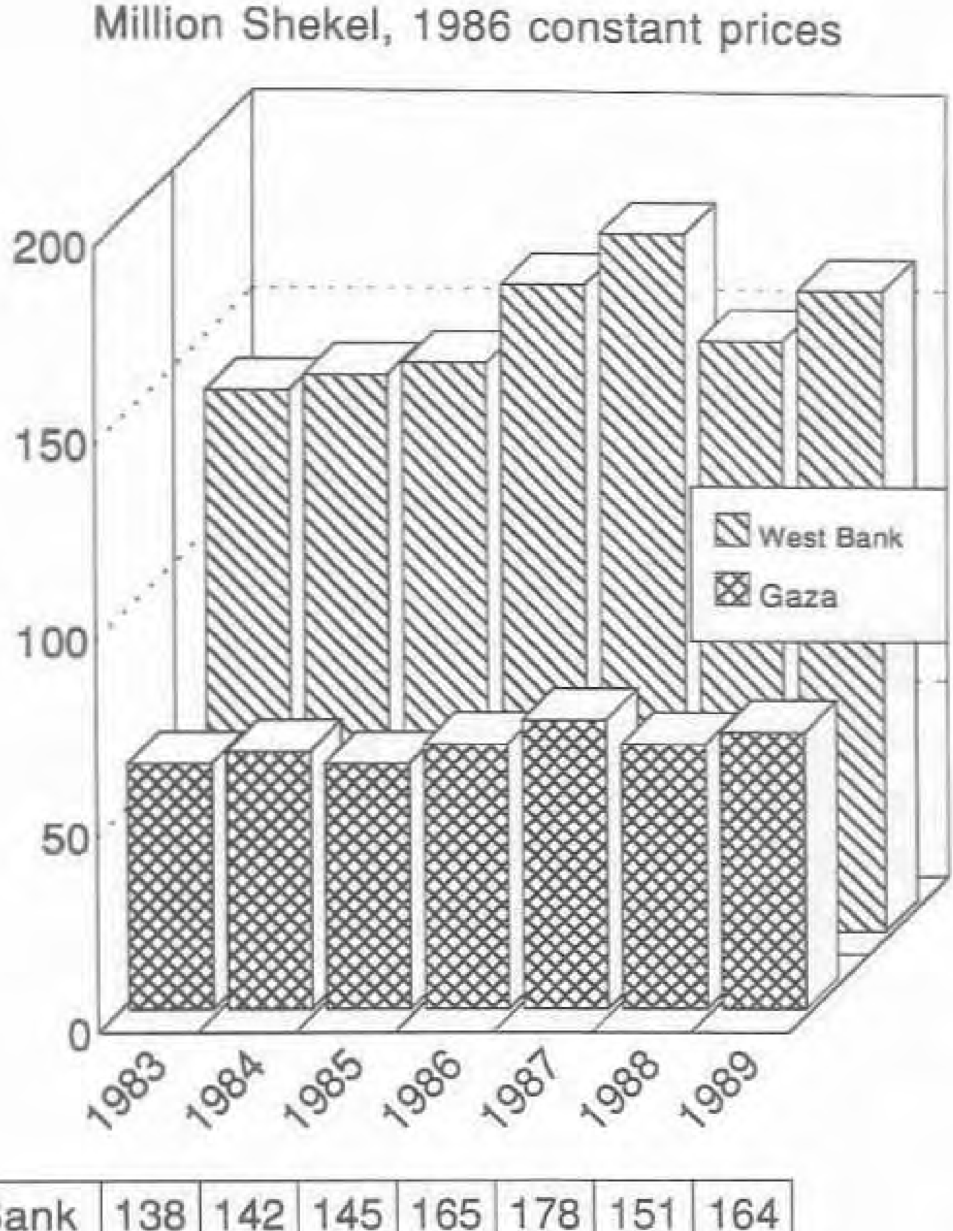
Figure 4
Labour force of the Occupied Territories



Employed	204	212	212	211	215	222	232	241	242	261	277	282	279
% in Work	33	33	33	32	33	34	34	34	33	35	37	38	36
Aged 15+	619	639	641	643	643	653	682	701	722	746	738	751	771

Source: Israel Central Bureau of Statistics, 1993

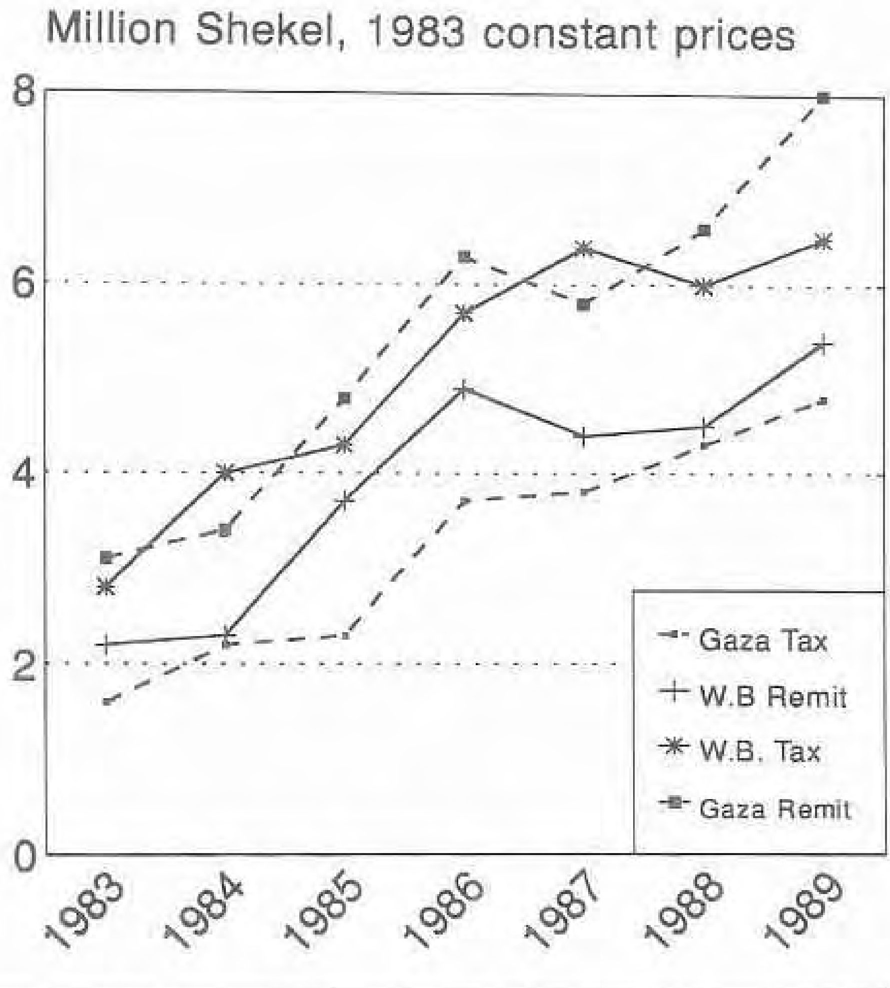
Figure 5
State Spending in the Occupied Territories



West Bank	138	142	145	165	178	151	164
Gaza	63	66	63	68	74	68	71

Source: Israel Central Bureau of Statistics, 1993

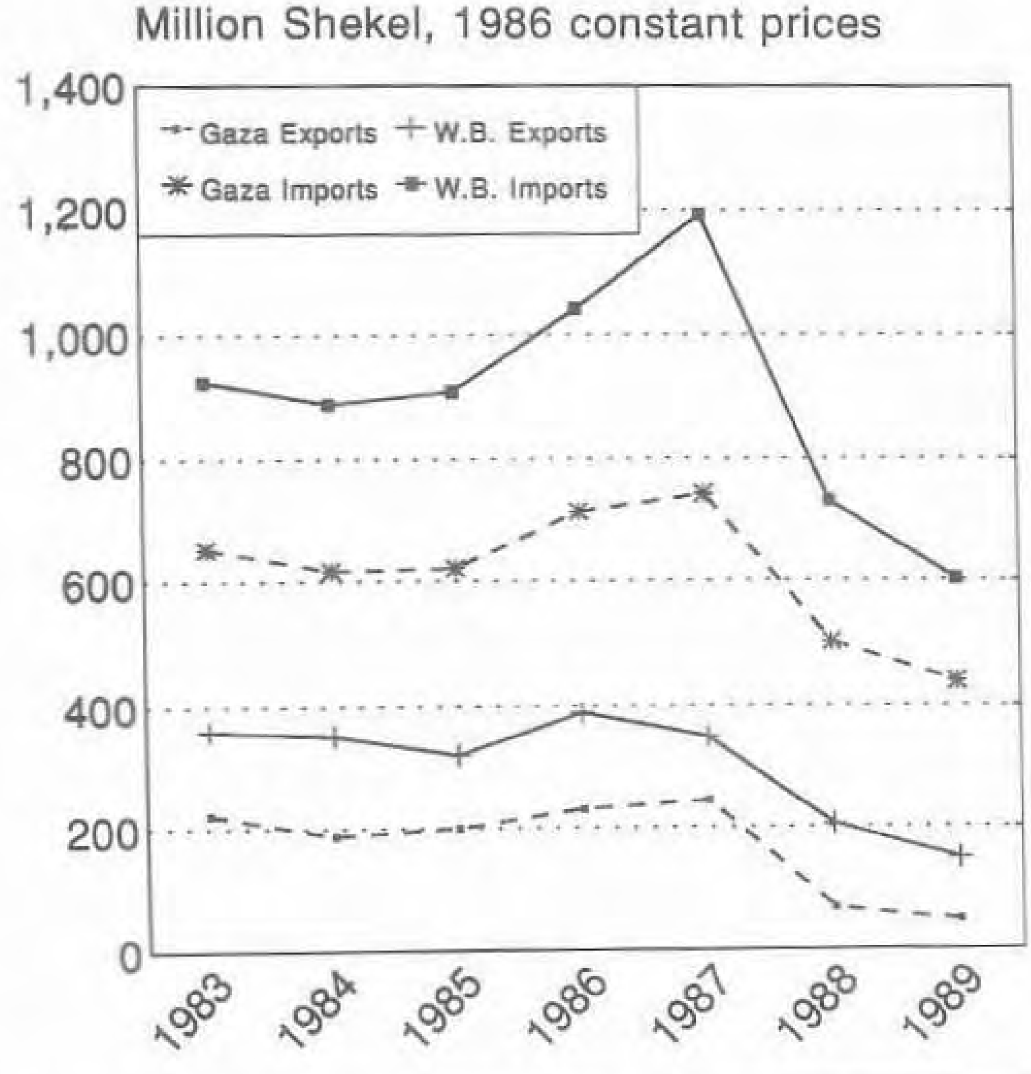
Figure 6
Remittances and Taxes



Gaza Tax	1.6	2.2	2.3	3.7	3.8	4.3	4.8
W.B Remit	2.2	2.3	3.7	4.9	4.4	4.5	5.4
W.B. Tax	2.8	4	4.3	5.7	6.4	6	6.5
Gaza Remit	3.1	3.4	4.8	6.3	5.8	6.6	8

Source: Israel Central Bureau of Statistics, 1993

Figure 7
Trade of the Occupied Territories



Gaza Exports	222	188	200	231	245	70	50
W.B. Exports	360	352	321	388	349	205	150
Gaza Imports	653	617	621	715	743	500	439
W.B. Imports	925	889	908	1,042	1,192	732	602

Source: Israel Central Bureau of Statistics, 1993